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FISCAL IMPACT STATEMENT

LS 6423 | **NOTE PREPARED:** Feb 2, 2010
BILL NUMBER: HB 1336 | **BILL AMENDED:** Feb 1, 2010

SUBJECT: State Investment in Aggressive Lenders.

FIRST AUTHOR: Rep. Bardon | **BILL STATUS:** As Passed House
FIRST SPONSOR: Sen. Hershman

FUNDS AFFECTED: GENERAL | **IMPACT:** State
X DEDICATED
FEDERAL

Summary of Legislation: (Amended) The bill

(1) defines an "aggressive lender" as a financial institution that engages in a practice of making consumer loans in Indiana at rates of interest that exceed the maximum finance charge allowed for supervised loans under the Uniform Consumer Credit Code;
(2) exempts from the definition of aggressive lending: (A) small loans by pay-day lenders; (B) credit cards that are offered, but not issued, by a financial institution; and (C) credit cards issued to a person that is not a resident of Indiana; regardless of whether the finance charge would otherwise make it an aggressive loan;
(3) provides that charges permitted by Indiana financial institutions, transaction fees on cash advances no greater than a total of 4%, and any portion of a penalty interest rate that pertains to balances on accounts that are more than 65 days delinquent are not to be considered in calculating whether the interest rate constitutes aggressive lending;
(4) requires consideration of any interest rate or fee attributable to a universal default provision;
(5) requires the Department of Financial Institutions (DFI) to determine whether a financial institution is an aggressive lender;
(6) provides that a financial institution determined to be an aggressive lender is ineligible to serve as a depository for public funds;
(7) provides that public funds be withdrawn from an aggressive lender and reallocated to other public depositories in a secure and prudent manner as directed by the State Treasurer in consultation with the director of the Department of Financial Institutions;
(8) provides that the Public Employees' Retirement Fund (PERF) and the Teachers' Retirement Fund (TRF) must divest themselves of direct holdings in financial institutions determined to be aggressive lenders;
(9) provides an exemption from divestiture if divesting would cost more than 5% of the value of the holding;
(10) establishes an advisory board to determine whether the divestment of PERF or TRF's direct holdings

in an aggressive lender would cause brokerage liquidation costs to exceed 0.5% of the value of the holding and permits the board to set a new divestment schedule in such a case;
(11) limits the divestment schedule for such a holding to ten years;
(12) prohibits a financial institution from imposing a service charge on a political subdivision or the state for the purchase of a United States Treasury Note;
(13) permits local government investment officers to invest in municipal securities issued by an Indiana local governmental entity, a quasi-governmental entity related to the state, or a unit of government, municipal corporation, or special taxing district in Indiana so long as the issuer has not defaulted on an obligation within the 20 years preceding the date of the purchase;
(14) replaces the requirement that money be invested in transaction accounts and certificates of deposit with the depository quoting the highest interest rate with the authority to invest in a depository offering any one of the top three interest rates so long as the reason for choosing the alternate depository is noted in the memorandum of quotes;
(15) provides that a unit may not invest more than 50% of the unit's total public funds that are invested at any point in time in nonfederally insured deposit accounts;
(16) requires the Board for Public Depositories to meet at least once each calendar quarter;
(17) provides for geographical representation on the Board for Public Depositories;
(18) requires the four Governor appointments to include a chief executive officer or a chief financial officer of a depository and that each appointment represent a different segment of the financial institutions industry based on total assets;
(19) specifies that the terms of the appointed member is four years and that a member's term does not extend beyond the appointed term;
(20) permits the Governor to reappoint a member if the individual meets the requirements at the time of reappointment;
(21) provides that a simple majority of the board members voting is required to approve an action by the board instead of a unanimous vote;
(22) changes the notice requirement for meeting notices from ten days to two days;
(23) allows the board to fix the assessment rate at the times the board determines are necessary instead of twice each year;
(24) provides that the Board for Depositories may consider capital adequacy, liquidity, and asset quality in addition to any study by actuaries in establishing any change in the reserve for losses;
(25) increases the amount of anticipatory warrants the board may issue to pay immediate claims when the assets in the Public Deposit Insurance Fund are not sufficient to pay claims from $1,500,000 to $300,000,000;
(26) permits the board to accept as collateral bonds or other obligations that the board could not invest in if the board determines the obligations are acceptable collateral;
(27) permits the board to determine whether a depository may withdraw collateral when the amount of public funds on deposit is at least 10% less than the market value of securities pledged as collateral;
(28) allows the board to determine the amount and type of substituted securities a depository may provide to insure the insurance fund's solvency;
(29) provides that the market value of the substituted securities as of the date of delivery may be less than, but not exceed, the amount determined by the board;
(30) provides that a joint investment fund may be invested or reinvested only in investments that are permitted for political subdivisions;
(31) limits the maximum deposit of state and local public funds a public depository may have at any time to 100% of the balance in the public deposit insurance fund unless the depository secures the excess amount of the deposit with assets of the depository;
(32) eliminates a report by the PERF to the board for depositories' secretary-investment manager and an

interest calculation concerning the coverage of local police and firefighter pension funds;
(33) requires a semi-annual report for every financial institution that has public funds on deposit; and
(34) requires the Department of Financial Institutions to review the report and compare public deposits and risks in relation to the depository's statement of condition and to communicate any concerns to the treasurer of state.

Effective Date: Upon Passage; July 1, 2010.

Explanation of State Expenditures: (Revised) *Department of Financial Institutions (DFI)*: This bill would increase administrative expenditures for the DFI by requiring the DFI to schedule hearings to determine if a lender is an "aggressive lender" and to publish a quarterly notice in the *Indiana Register*. The DFI also would have to review semi-annual reports for every financial institution that is a public depository and compare public deposits and risks in relation to each depository's report and statement of condition. The bill's requirements represent an additional workload on the agency outside of the agency's routine administrative functions. The DFI reports that existing staffing and resource levels are being used to capacity. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend on legislative and administrative actions.

The bill describes an aggressive lender as a lender making consumer loans in Indiana that provide for a loan finance charge that exceeds the limits on loan finance charges for supervised loans specified in IC 24-4.5-3-508 as adjusted in accordance with IC 24-4.5-1-106. Under current statute, lenders based in Indiana may not, except for payday lenders exceed the cap included in IC 24-4.5-3-508.

The DFI is funded by bank examination fees placed into dedicated funds. The DFI received an appropriation of $8.5 M for FY 2010. The DFI generated approximately $8.3 M in total revenue during FY 2009. Revenue is placed into the Department of Financial Institutions Fund.

(Revised) *PERF and TRF Divestiture:* TRF originally estimated their cost of divestiture of direct holdings in aggressive lenders to be $125,000 in the first year and costs ranging from $88,000 to $125,000 in future years. PERF estimated first-year costs from divestiture of direct holdings in aggressive lenders to range between $200,000 and $1.5 M, depending upon the number of securities that end up on the restricted list. The costs include outside service providers, staff time, and trading costs. As amended, PERF and TRF are not required to divest direct holdings of an aggressive lender if the estimated cost of divestment is greater than 5% of the total value of the direct holdings in the lender. In addition, PERF and TRF are not required to divest direct holdings of an aggressive lender under the schedule specified by the bill if the divestment would cause brokerage liquidation costs to exceed 0.5% of the value of the direct holding. The bill also specifically excludes indirect holdings in a private market fund that includes an aggressive lender or an actively managed investment fund that includes an aggressive lender from the divestiture requirements. It is unknown at this time what impact these provisions will have on reducing the original costs estimated by TRF and PERF.

State Treasurer's Office: The cost of divestiture will depend upon the number of deposits that are withdrawn from financial institutions that are determined to be aggressive lenders.

Board for Depositories: The bill makes changes to the qualifications of the Governor's appointments to the Board for Depositories (Board) and to the procedures of the Board including the necessary number for approval of items and the reduction of amount of notice necessary before a meeting of the Board. None of these changes is expected to have fiscal impact.

The Board consists of the Governor, the State Treasurer, the State Auditor, the Chairman of the Financial Institutions Commission, the Chief Examiner of the State Board of Accounts, and four members appointed by the Governor who are Indiana residents and have had substantial expertise in commercial lending with depositories. Under the bill, each of the appointed members must be a CEO or CFO of a depository at the time of appointment. The bill requires the Governor to provide for geographic representation of all regions in making these appointments. The bill also requires the appointments to come from different size depositories in terms of depository assets ranging from less than $500 M to at least $5,000 M. These qualifications changes would affect appointments made after June 30, 2010.

Explanation of State Revenues: *PERF and TRF Divestiture:* This bill could affect fund revenues to the extent that PERF and TRF sell investments in financial institutions that have been determined to be aggressive lenders at a different price than they would have sold them otherwise. Fund revenues could also be affected if PERF or TRF reinvest the money removed from aggressive lenders and the new investments bring in more or less revenue than was yielded by the original investment. The amount of this possible effect is indeterminable.

(Revised) *Deposit and Investment of Public Funds:* The bill will have indeterminate fiscal impact on state and local government concerning the rate of return and the amount of risk on money in funds controlled by the investing officer and available for investment. Details of the changes follow:

Investment of Public Funds - The bill would do the following:

(1) The bill would prohibit a state or local officer to deposit public funds in a financial institution which is deemed to be an aggressive lender. The institutions would be removed from the Approved Depository List. This list contains approximately 200 financial institutions.
(2) The bill would also prohibit a state or local officer to invest more than 50% of the unit's total public funds at any one time in non-federally insured deposit accounts.

These provisions of the bill could change the make up of portfolio held by state or local government with indeterminate fiscal impact on the return and risk.

Depository Placement - Current law requires an investment officer to accept the bid of a depository that offers the highest rate of return for investment of funds in certificates of deposit. The bill allows the investment officer to place funds in a certificate of deposit with a depository quoting the second or third highest rate of interest and noting the reason for the placement. The rate of return would be diminished, but potentially local depositories could receive more deposits even if they are not paying the highest rate of interest available.

Board for Depositories: Other changes to the Board's procedure concerning the Public Deposit Insurance Fund (PDIF) have indeterminate fiscal impact. The bill allows the Board to set the assessment rate to provide assets in the PDIF more than twice a year. However, there are no changes to a requirement that the rate may not change more than 2% in any six month period. The bill also increases the limit on anticipatory warrants issued by the Board to pay claims on the PDIF from $1.5 M to $300 M.

The PDIF is maintained and operated by the Board and insures the deposits of all public money in Indiana depositories. The PDIF is funded by assessments payable by every depository that holds public funds. The PDIF assessment was suspended in 1985, but until that time it was a monthly fee not to exceed 2% of the sum of the minimum public fund balances that public funds depositories held during the month. As of June 30, 2009, the net assets of the PDIF totaled $308,222,700.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Local Investment Requirements:* The changes outlined above for investment in the *Explanation of State Revenues* concerning public funds are also made relative to investment of public funds by county treasurers or fiscal officers of political subdivisions.

State Agencies Affected: DFI; PERF; TRF; State Treasurer; Board for Depositories

Local Agencies Affected: Local units with investment responsibilities.

Information Sources: John Schroeder, DFI, 317-232-5836;*State of Indiana List of Appropriations Made by the 2009 Indiana General Assembly for the Biennium July 1, 2009, to June 30, 2011;* Gina Williams, DFI, 317-232-5841.

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